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Comptroller of the Currency
Administrator of National Banks

Community Bank Supervision

Comptroller's Handbook

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EP

Background

This booklet explains the philosophy and methods of the Office of the Comptroller of the Currency (OCC) in supervising community banks. It consolidates and updates guidance previously published in two booklets of the *Comptroller's Handbook,* "Community Bank Procedures for Noncomplex Banks" and "Community Bank Risk Assessment System," and generally applies to supervision of national banks with less than $1 billion in total assets. The revised procedures in this booklet should improve examiner focus on areas of risk within a community bank; the result should be more efficient and streamlined examinations. While this booklet serves as the primary guide to the OCC's supervision of community banks, it should be used in conjunction with other booklets, including "Bank Supervision Process." (National banks having more than $1 billion in assets or having at least one affiliated national bank with more than $1 billion in assets will continue to be supervised according to the OCC's "Large Bank Supervision" program.)

In order to satisfy statutory requirements, to ensure that supervisory efforts are tailored to each institution's risks, and to prevent such efforts from imposing unnecessary burdens, the OCC has identified certain broad objectives that examiners should meet in supervising community banks. To achieve these objectives, examiners should use the core assessment standards and, as needed, optional procedures. The OCC's objectives in supervising community banks are to:

- Determine the condition of the bank and the risks associated with current and planned activities by testing the bank's practices.
- Evaluate the overall integrity and effectiveness of risk management systems by testing the bank's practices.
- Enforce banking laws and regulations.
- Communicate findings, recommendations, and requirements to bank management and directors in a clear and timely manner, and to obtain informal or formal commitments to correct significant deficiencies.

- Verify the effectiveness of corrective actions or, if actions have not been undertaken or accomplished, pursue resolution through more aggressive supervision or enforcement actions.

This booklet introduces several program revisions designed to ensure that risks are properly assessed and evaluated. The most significant revision described herein is a framework consisting of the following three components:

- **Core Knowledge** — the database of information that defines the bank's culture, risk tolerance, and other internal and external factors. This system modifies the format and content of such information, enabling examiners to communicate critical data to each other with greater consistency and efficiency.

- **Core Assessment** — standards or procedures that guide examiners in reaching conclusions regarding both risk and CAMELS ratings. Examiners must reach these conclusions during the course of each supervisory cycle, i.e., 12 months or 18 months, to meet the requirements of a full-scope examination. This booklet introduces the core assessment standards for community banks (see appendix A).

- **Optional Procedures** — detailed guidance that explains how to examine specific activities or products that warrant extra attention beyond the core assessment. These procedures are found in other booklets of the *Comptroller's Handbook*. Examiners may decide which optional procedures to use during pre-examination planning or after drawing preliminary conclusions during the core assessment.

While these three components are essential to community bank supervision, this booklet focuses primarily on the core assessment standards. The revisions were designed to address the need for examiners to be flexible when developing supervisory strategies and conducting examinations that meet statutory requirements. The revised structure reflected in this booklet provides a consistent framework for supervisory activities, thereby allowing examiners to respond to the underlying risks in each community bank.

The principal enhancement to community bank supervision is the introduction of *core assessment standards*. The core assessment standards are designed to achieve the following operational and administrative objectives:

- Incorporate supervision by risk into the community bank examination process in a consistent fashion.

- Reflect the interrelationship of CAMELS ratings and risk-based supervision by requiring examiners to assess risk management by testing a bank's practices. When necessary, the standards incorporate testing and verification for community bank supervision.

- Define minimum conclusions that examiners must reach in each examination, while preserving flexibility by allowing examiners to vary the amount of supporting detail or volume of work required to reach those conclusions.

- Provide more explicit direction for less experienced examiners by developing detailed procedural guidance to be used as needed to reach key conclusions and objectives.

- Specify when it is appropriate to broaden the scope of the examination to include additional examination procedures.

- Ensure conformance with statutory requirements for on-site examinations.

- Assign risk conclusions and composite and component CAMELS ratings.

Supervision by Risk

While banking is a business of taking risks, all banks must have risk management systems that identify, measure, control, and monitor risks. Such systems should be able to classify risks according to their significance.

Risks that community banks assume generally derive from traditional products and services and limited geographic diversity. Therefore, risk management systems are typically less sophisticated than in larger or more complex banks. The OCC focuses its examinations of community banks on the banks' practices. Using assessments of these practices, OCC examiners draw conclusions about the adequacy of the banks' risk management systems. When risks are higher or products are more complex, examiners will expand the focus of their examination to ensure quality supervision.

When community banks are part of a holding company or organization of chain banks, examiners must be cognizant of the interrelationship of affiliates. While the OCC's supervision focuses on individual banks, the examiner must recognize that risks at individual institutions may be mitigated or increased across the holding company.

(For more information on supervision by risk and risk management, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.)

Measuring and Assessing Risk

The three-part supervisory structure provides a consistent policy framework for the OCC in tailoring examination activities to the level of risk within any given examination area. *Core knowledge* provides a database of information on the institution. This knowledge is a foundation for risk assessment by capturing elements of the bank's culture and environment. Core knowledge helps the examiner determine when supervisory activities must be expanded beyond the core assessment standards.

The *core assessment* standards establish the minimum conclusions examiners must reach to assess risks and make conclusions regarding CAMELS. Examiners meet objectives within each examination area. They determine how much supporting detail or work is required in each area by considering the condition of the bank, the quantity of risk, the quality of risk management, the background and experience of the examination team, and other relevant information.

The *optional procedures* provide detailed guidance on the examination of specific activities or products warranting additional scrutiny beyond that provided in the core assessment. Examiners may decide whether to use certain optional procedures during pre-examination planning or after reviewing the findings and conclusions of core assessments.

Core Assessment

The core assessment standards contain conclusions examiners must reach and objectives they must meet during the course of the examination cycle. These standards focus on testing bank practices, thereby allowing the examiner to reach a conclusion about the bank's risk management practices.

Examiners use judgment in deciding how much supporting detail or work is necessary to meet the objectives under the core assessment standards. As outlined in PPM 5400-8, "Examination Working Papers," examiners should use common sense in determining the appropriate scope of documentation to support conclusions. The level of detail should be commensurate with the risks facing the institution. The examiner should generate and retain only those documents necessary to support significant conclusions, ratings changes, or changes in a risk profile.

While examiners must achieve each objective in the core assessment standards, they usually will not need to carry out every procedure listed under each objective. Instead, guided by the bank's condition and risk profile, experienced examiners may be able to simply summarize their conclusions under each objective. For less experienced examiners, the core assessment standards provide clarifying steps to help them achieve the minimum objectives. These additional steps are practices traditionally used by experienced examiners in reaching supervisory conclusions within each examination area.

When specific activities or risks are present warranting an expansion of the scope of the examination, examiners should make use of optional examination procedures found in other *Comptroller's Handbook* booklets. For example, if a bank has a higher-than-normal risk profile, the OCC will expect the bank to have more sophisticated or formalized policies and processes to monitor and control the risk. In that case, the examiner-in-charge, in consultation with the supervisory office, will establish a specialized examination scope and strategy to more fully assess the risk management process. If an on-site examination based on the core assessment standards reveals that the bank is not following sound principles, the examiner should expand the examination. The examiner should focus the expansion on the specific areas or items of concern and tailor the expansion to include additional transaction testing or a more thorough assessment of the risk management process. Supervisory office approval is required only when additional workdays are needed.

The core assessment standards directly link the risk evaluation process to the assignment of a CAMELS rating.   As explained in OCC Bulletin 97-1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings," the effectiveness of risk management bears heavily upon the rating given each CAMELS component. The core assessment standards provide direction for reaching conclusions about CAMELS components, while also incorporating risk assessment factors in the examination.

Additionally, given the importance of a strong internal control environment, standards for assessing internal controls are included. These internal control standards are consistent with broadly accepted criteria for establishing internal control and evaluating its effectiveness, as defined by the Commission of Sponsoring Organizations of the Treadway Commission (COSO).

The core assessment standards seek to improve consistency, reduce regulatory burden, and provide additional flexibility for examiners in conducting examinations. When using the core assessment standards, examiners should:

- Employ critical thinking and common sense in applying the standards. Specifically, examiners must use reasoned judgment in determining when to expand the core assessment or to increase the level of detail needed to support the core assessment conclusions.

- Practice good communication skills in investigating and judging what processes are appropriate within a given bank.

- Understand that effective on-site examinations leverage off supervisory activities that take place during the rest of the examination cycle.

The core assessment standards do not target specific laws, rules, regulations, and policies. Nonetheless, examiners who perform the procedures must understand the laws and policies that relate to the area under examination and must remain alert for any noncompliance with law, regulation, or policy. Any such noncompliance must be noted and corrective action discussed with management. Also, examiners should ensure that follow-up from previous examinations includes corrective action for violations. When potential violations are noted, examiners should refer to the expanded procedures found in the appropriate *Comptroller's Handbook* booklets.

Risk Assessment System

The community bank risk assessment system (RAS) gives examiners a consistent means of measuring the risk and determining when the core assessment standards should be expanded. To specify **aggregate risk** or **composite risk** and **direction of risk,** an examiner uses conclusions from the core assessment standards or optional procedures and guidance in the RAS.

Aggregate or **composite risk** is a summary judgment about the level of supervisory concern; it incorporates judgments about the quantity of risk and the quality of risk management (examiners weigh the relative importance of each). Examiners characterize such risk as low, moderate, or high for each of the nine categories of risk. In assessing aggregate risk, examiners should perform the activities and use the resources outlined in supervisory strategies. Examiners should be guided by the specific characteristics of low, moderate, or high risk in each of the nine categories of risk when performing a core assessment.

Direction of risk is the probable change in the bank's risk profile over the next 12 months and is characterized as decreasing, stable, or increasing. The direction of risk often influences the supervisory strategy, including how much validation is needed. If the risk is decreasing, the examiner expects, based on current information, aggregate risk to decline over the next 12 months. If the risk is stable, the examiner expects aggregate risk to remain unchanged. If the risk is increasing, the examiner expects aggregate risk to be higher in 12 months.

Because an examiner expects aggregate risk to increase or decrease does not necessarily mean that he or she expects the risk level at the bank to change within 12 months. An examiner can expect movement **within** the risk level (e.g., risk is decreasing but not enough to change the characterization of that risk as high). In such circumstances, examiners should explain in narrative comments why no change in risk level is expected.

Examiners should complete the RAS for each community bank at the end of each examination cycle. Further, the RAS should be updated any time the examiner becomes aware of changes to the risk profile on an interim basis, e.g., when performing quarterly monitoring. The RAS for individual banks is recorded in the OCC's electronic information system.

The Supervision Process

The supervision of community banks is a continual process. Supervisory planning, examining through the use of core assessment standards and optional procedures, and communicating the results are integral parts of the supervision process. (Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for more detailed information.)

Planning

Supervisory strategies are dynamic documents that direct all supervisory activities. They do much to ensure that sufficient resources are available to address risks and fulfill statutory requirements. The strategy should focus examiners' efforts on monitoring the condition of the bank, and should seek bank management's commitment to correct previously identified deficiencies. At a minimum, the supervisory strategy for community banks should include meeting the core assessment standards. The strategy should direct examiners to expand the examination beyond these standards for areas of higher risk or supervisory concern.

Each supervisory strategy is based on:

- The **core knowledge** of the bank, including its:
  - Management.
  - Risk profile.
  - Strengths and weaknesses.
  - Supervisory history.
  - Market(s).
  - Products and activities.
  - Applicable economic conditions.

- OCC supervisory standards including:

  - **Core assessment** standards.
  - Other examination guidelines (e.g., **optional procedures** in the *Comptroller's Handbook*).
  - Supervisory priorities of the agency that may arise from time to time.

- Statutory examination requirements.

Examining

Examining is discovering a bank's condition, determining the risk profile of the bank, ensuring correction of significant deficiencies, and monitoring ongoing activities. The core assessment standards recognize the ongoing nature of examining and contain guidance for quarterly monitoring as well as on-site activities.

The OCC's approach to community bank supervision focuses on the importance of the on-site examination to determine and verify the bank's condition. Through performance-oriented testing, the community bank examiner gains an understanding of how bank management identifies, measures, controls, and monitors its risk. For example, the core assessment standards direct the examiner to sample loans. From this transaction testing, the examiner will make reasoned judgments about the quality and consistency of underwriting or other risk management systems employed by the bank.

Examiners must also complete a review of bank information systems on a 12- to 18-month cycle. Minimum standards for bank information systems reviews are under development. In the interim, examiners determine the scope of the review based on the risk present.

As for fiduciary, asset management, compliance, and Community Reinvestment Act (CRA) activities, examiners must review them and update the bank's ratings every 24 months to 36 months. For consumer compliance examinations in community banks with total assets of less than $250 million or other low-risk community banks, examination activities are those outlined in "Community Bank Consumer Compliance" and appropriate CRA procedures. Minimum standards for fiduciary activities are under development. In the interim, examiners determine the scope of the review based on the risk present.

Community bank examiners seek and monitor correction of identified deficiencies throughout the supervisory cycle. During on-site examinations, examiners focus on the bank's actions to correct the root cause of deficiencies. Interim monitoring is aimed at ensuring that management is taking timely steps to address the root cause of identified deficiencies.

In community banks, monitoring is directed at confirming that corrective action is being taken, identifying changes in a bank's condition or risk profile, modifying strategies in response to changing risk, and providing the means to respond to bank management's questions. Monitoring ensures more effective and proactive supervision, as well as facilitating a more focused and efficient on-site examination. For example, during an on-site examination examiners should be focused on testing any corrective actions; most of the necessary data-gathering should have already been accomplished through monitoring.

Communicating

The OCC is committed to continual, effective communication with the banks that it supervises. All communications — formal and informal conversations and meetings, examination reports, as well as other written materials — should be professional, objective, clear, informative, and consistent.

Most important, examiners must clearly and concisely communicate significant deficiencies and excessive risks to the bank. When examiners find significant weaknesses or excessive risks, these issues should be thoroughly discussed with bank management and the board of directors. The institution should be given a reasonable opportunity to resolve differences and correct weaknesses. Significant deficiencies and excessive risks, along with the corrective action to which the board has committed, should be detailed in the report of examination's matters requiring board attention (MRBA) or in other periodic written communications. (For specific guidance on MRBAs, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.)

Examiners use the core assessment standards both to monitor community banks and to conduct on-site examinations of them. Each quarter, examiners must draw the conclusions and meet the objectives under community bank monitoring. Examiners routinely accomplish this monitoring off-site. Within a bank's 12- or 18-month supervisory cycle, examiners must draw conclusions and meet objectives listed under the community bank on-site examination section.

Community Bank Monitoring

For all community banks, examiners must, at a minimum, draw the following *conclusion* relating to the bank and meet the specific *objectives* each quarter (within 90 days after the end of quarter between full-scope, on-site examinations). The procedures listed under each objective are optional steps to guide the examiner to the objectives. Examiners *do not* have to answer optional questions or complete optional steps.

Conclusion: The overall condition and risk profile of the bank (has/has not) changed.

Objective 1: Determine any significant financial trends evident in the bank's condition.

1. Conduct a brief quarterly financial analysis of the bank. Assess any significant trends in the bank's financial condition or risk profile. Refer to:

   - Previous monitoring information.
   - The Uniform Bank Performance Report (UBPR).
   - The bank expert system (BERT).
   - Any other computer-generated OCC analysis tools, as appropriate.

2. In conjunction with your analysis, and only as appropriate, discuss the bank's management, condition, and associated risks with the portfolio manager, previous EIC, or the assistant deputy comptroller.

Objective 2: Determine whether any significant changes in the risk profile are evident through discussion with bank management.

Contact bank management to discuss current information about the bank. This discussion can be accomplished by telephone or an on-site meeting. Possible discussion topics are:

- Issues that may affect the bank's risk profile, including:
  - Significant changes in bank products or services. (Refer to appendix B of the "Examination Planning and Control" booklet of the *Comptroller's Handbook*.)
  - Changes in bank management, key personnel, or operations.
  - Significant trends or changes in the local economy or business conditions.
  - Purchase, acquisition, or merger considerations.
  - Changes in technology, including operational systems, or plans for new products/activities that involve new technology.
  - Management concerns about the bank or OCC's supervision.
  - Other issues that may affect the risk profile.
- Financial performance and trends.

Objective 3: Perform appropriate follow-up analysis on previously identified weaknesses.

If applicable, assess the progress in correcting outstanding matters requiring board attention (MRBA), violations, or enforcement actions.

Objective 4: Confirm or update CAMELS ratings and risk assessments.

1. As appropriate, and in consultation with the appropriate supervisory office official, determine whether the risk assessment system or CAMELS component ratings should be changed. (For guidance, refer to the risk assessment system, appendix B, and OCC Bulletin 97-1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings.")

2. Determine whether the results of the quarterly review or other monitoring activities affect the next on-site examination with regard to:

   - Scope.
   - Timing or scheduling.
   - Examination resources (expertise, experience level, etc.).

Objective 5: Communicate and document findings from monitoring activities.

1. Update applicable OCC electronic files, including but not limited to:

   - Any changes to data residing in OCC supervisory information systems:
     – CAMELS ratings.
     – Risk assessment system.
     – Supervisory strategy.
   - Examination comments or follow-up analysis.

2. As appropriate, communicate and document any changes in accordance with PPM-5400-8, "Examination Working Papers," and other OCC guidance.

   Note: Documentation should be sufficient to support conclusions based on the extent of findings and work performed. For example, if the findings do not reveal any changes in CAMELS or risk profiles, the only required documentation of this analysis is a brief conclusion on the bank's condition in appropriate OCC electronic files. If there are significant changes (e.g., in CAMELS ratings, risk levels, or management), the examiner documents the analysis in OCC electronic files and working papers in accordance with guidelines prescribed in PPM 5400-8, "Examination Working Papers," and the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

3. If significant issues are identified, determine whether to send written communication or conduct a meeting with the board or management.

Community Bank On-site Examination

The core assessment for on-site examinations is structured according to CAMELS. Risk considerations and references to the community bank RAS are noted throughout the standards. Each section has minimum *conclusions* that must be drawn and *objectives* that must be met during the course of the examination. The procedures listed under each objective are optional steps to guide the examiner to the objectives. Examiners *do not* have to answer the optional questions or complete the optional steps. The on-site procedures are made up of the following sections: examination planning; capital; asset quality; management; earnings; liquidity; sensitivity to market risk; other areas of examination interest; examination conclusions; and examination communication, review, and closing.

Examination Planning

If any of the bank's component CAMELS ratings are 3 or worse, or if any aggregate risk category is rated moderate and increasing or high, the EIC in consultation with the supervisory office should expand the procedures in that area. For example, if the aggregate credit risk is moderate and the direction is increasing, the examiner should expand the extent of testing by completing specific bank activity procedures as provided in the *Comptroller's Handbook* booklets.

Objective 1: Determine the characteristics of the bank and identify the preliminary scope and objectives of the examination.

1. Review the following for the bank to be examined.

    - Previous reports of examination.
    - Other applicable regulatory agency reports (e.g., holding company reviews).
    - OCC electronic files:
        - Examination analysis comments.
        - Quarterly review comments.
        - Risk assessment system.
        - Financial and statistical models and databases.
    - OCC correspondence file.

- Previous examination working papers.
- Any other internal or external information deemed pertinent to the bank.

2. As appropriate, discuss the bank and associated risks with the portfolio manager and assistant deputy comptroller.

Objective 2: Plan and coordinate the on-site examination.

1. Create an examination packet for review by assigned examination personnel that includes the following:

   ☐ A copy of the previous full-scope, on-site safety and soundness examination report.
   ☐ Copies of the most recent reports resulting from other supervisory activities (e.g., specialty area examinations).
   ☐ Other regulatory agency reports, as appropriate (e.g., holding company reviews).
   ☐ Printed copies of the bank's most recent UBPR and other models (e.g., BERT).
   ☐ A report diskette that contains all mandatory core pages, optional core and supplemental pages as needed, and downloaded financial data from the National Bank Surveillance Video Display System (NBSVDS).
   ☐ Printed copies of information from appropriate OCC electronic files.
   ☐ Appropriate working papers from the previous examination.

2. As part of the planning process, and generally about four to six weeks before the start of the examination, contact bank management and discuss the following:

   - The timing of the examination.
   - The scope and objectives of the examination.
   - General information about examiners' schedules, staffing levels, and projected time during which examiners will be at the bank.
   - The availability of key bank personnel during the examination.
   - Significant changes in bank products or services.
   - Changes in bank management, key personnel, or operations.

- Significant trends or changes in the local economy or business conditions.
- Purchase, acquisition, or merger considerations.
- Changes in technology, including operational systems, or plans for new products/activities that involve new technology.
- Management concerns about the bank or OCC's supervision, including any areas the bank would like the OCC to consider in the examination scope.

Objective 3: Determine the reasonableness of the bank's supervisory strategy.

1. As warranted, review and assess the appropriateness of the current supervisory strategy for the bank. Consider:

    - Information obtained from contacting bank management.
    - Findings from monitoring activities.
    - Discussions with supervisory office personnel.
    - The supervisory cycle for specialty examinations.

2. If needed, modify the supervisory strategy by:

    - Obtaining approval from the appropriate supervisory office.
    - Updating, archiving, and saving the previous and modified strategies in OCC electronic files.

Objective 4: Prepare for on-site examination activities.

1. Finalize the scope and objectives of the examination and prepare a written scope memorandum, as appropriate.

2. Coordinate the examination with other regulatory agencies, as necessary.

3. Prepare assignments for examining staff covering all areas to be examined. The assignments should include time frames for completion of on-site activities.

4. After initial contact with the bank, but generally no later than three weeks before the start of the examination, send a request letter to the bank that provides:

    - The examination start date.
    - The scope and objectives of the review.
    - Advance information the bank must provide to the examination team, including due dates for submission of requested items.
    - Information the bank must have available for the examiners upon their arrival at the bank.
    - The name and telephone number of the OCC contact.

    Note: Use the standard request letter for community bank safety and soundness examinations as referenced in appendix C of this booklet. For specialty examinations, refer to appropriate booklets of the *Comptroller's Handbook* or interagency guidance. For banks with supervisory strategies expanded beyond the core assessment, customize the request letter to achieve stated supervisory objectives.

5. Prepare supplies and working papers files to take to the bank for the examination.

6. Open the analyses in applicable OCC electronic files using the date on which the examination begins.

Objective 5: Conduct on-site planning meetings.

1. Meet with the CEO and appropriate members of senior management, board members, or appropriate board committees at the beginning of the examination to:

    - Explain the scope of the examination, the role of each examiner, and how the team will conduct the examination.
    - Confirm the availability of bank personnel.
    - Identify communication contacts.
    - Answer any questions.

2. Meet with the examination staff at the beginning of the examination to confirm:

- Scope and objectives.
- Workdays.
- Assignments and due dates.
- Administrative duties.
- Guidelines for contact and communication between the examining team, bank management, and OCC supervisory offices.

Note: If the foregoing procedures do not provide sufficient detail or do not adequately prepare the examiner for conducting the on-site examination, refer to specific examination planning procedures in the "Examination Planning and Control" booklet of the *Comptroller's Handbook*.

Capital

Conclusion: Capital is rated (1, 2, 3, 4, 5).

Using the findings from fulfilling the following objectives and in consultation with the EIC and appropriate examining personnel, assign the component rating. Consider the following factors from OCC 97–1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings":

- The level and quality of capital and the overall financial condition of the institution.
- The ability of management to address emerging needs for additional capital.
- The nature, trend, and volume of problem assets, and the adequacy of allowances for loan and lease losses and other valuation reserves.
- Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.
- Risk exposure represented by off-balance-sheet activities.
- The quality and strength of earnings, and the reasonableness of dividends.
- Prospects and plans for growth, as well as past experience in managing growth.
- Access to capital markets and other sources of capital, including support provided by a parent holding company.

Objective 1: Conduct scope-setting and database management activities.

1. Review the documents included in the examination packet to identify any previous problems that require follow-up in this area.

2. If not previously provided, obtain and review these documents:

   ☐ The bank's current risk-based capital computation.
   ☐ Findings from monitoring activities.
   ☐ A list of principal shareholders (5 percent or more) and their ownership.

3. If necessary, update information about controlling ownership in applicable OCC electronic files.

4. As appropriate, calculate and distribute capital limits and shareholder information to other examiners.

Objective 2: Determine the adequacy of capital.

1. Review applicable information to identify trends. Consider:

   - Results from monitoring activities.
   - Management reports, UBPR, BERT, and QCALC calculations to compare the bank's ratios with those of peer banks.
   - The bank's present condition and future plans.

2. Consider the impact of the following on current or future capital adequacy:

   - Dividends.
   - Earnings.
   - Asset quality.
   - Historical and planned growth.
   - On- and off-balance-sheet activities.
   - Strategic initiatives.
   - Financial plans and budgets.
   - New products or services.
   - Related organizations.

3. Evaluate the sources of capital. Consider:

   - Earnings retention.
   - Ownership capacity — condition of principal shareholders, parent, or subsidiaries.
   - History with public or private offerings.

Objective 3: Determine the risk to bank capital posed by the aggregate level or direction of any applicable risks.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk has an adverse impact on current or future capital adequacy. Refer to the risk assessment system (appendix B), as needed. Comment as necessary. Consider:

	Aggregate		Direction		
	Yes	No	Yes	No	NA
Credit risk	☐	☐	☐	☐	☐
Interest rate risk	☐	☐	☐	☐	☐
Liquidity risk	☐	☐	☐	☐	☐
Price risk	☐	☐	☐	☐	☐
Foreign currency translation risk	☐	☐	☐	☐	☐
Transaction risk	☐	☐	☐	☐	☐
Compliance risk	☐	☐	☐	☐	☐
Reputation risk	☐	☐	☐	☐	☐
Strategic risk	☐	☐	☐	☐	☐

Objective 4: Determine whether to expand the procedures or develop a plan for corrective action.

If the risk to capital is moderate and increasing or high in any of the nine categories of risk, or if capital is rated 3 or worse:

- Determine whether management is able to correct the bank's fundamental problems.
- Consider whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklet(s) of the *Comptroller's Handbook*.
- Work with the EIC to propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Objective 5: Conclude the capital review.

1. Adjust the bank's reported capital ratios to reflect the results of the examination and distribute to appropriate examining personnel. Consider:

- Loan charge-offs.
- Examiner-directed provision expenses to the allowance for loan and lease losses (ALLL).
- Errors in financial reporting.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., on capital adequacy and MRBA) in the report of examination.

3. Update appropriate OCC electronic files and working papers.

Asset Quality

Conclusion: Asset quality is rated (1, 2, 3, 4, 5).

Using the findings from fulfilling the following objectives and in consultation with the EIC and appropriate examining personnel, assign the component rating. Consider the following factors from OCC 97–1, “Uniform Financial Institutions Rating System and Disclosure of Component Ratings”:

- The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices.
- The level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance-sheet transactions.
- The adequacy of the allowance for loan and lease losses and other asset valuation reserves.
- The credit risk arising from or reduced by off-balance-sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit.
- The diversification and quality of the loan and investment portfolios.
- The extent of securities underwriting activities and exposure to counterparties in trading activities.
- The existence of asset concentrations.
- The adequacy of loan and investment policies, procedures, and practices.
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal controls and management information systems.
- The volume and nature of credit documentation exceptions.

Objective 1: Conduct scope-setting activities.

Refer to the “Loan Portfolio Management” booklet of the *Comptroller’s Handbook* for additional guidance. Examiners should be familiar with that booklet, especially the relevant discussions on the quality of risk management, when setting the scope of asset quality reviews.

1. Review the documents included in the examination packet to identify any previous problems that require follow-up in this area.

2. If not previously provided, obtain and review reports management uses to supervise the loan portfolio, including but not limited to:

   - ☐ Loan trial balances.
   - ☐ Past-due and non-accrual reports.
   - ☐ Problem loan lists.
   - ☐ Concentration of credit reports.
   - ☐ Insider loan lists.
   - ☐ List of participations purchased and sold since the last examination.
   - ☐ Overdraft list.
   - ☐ Most recent ALLL analysis.
   - ☐ Findings from monitoring activities.
   - ☐ Latest loan review report, including any responses from bank officers.

3. Review the UBPR, BERT, and request information to assess the size, composition, and trends in the loan portfolio, as well as any off-balance-sheet exposures. Consider:

   - Current and planned loan growth in relation to bank capital and risk limits.
   - Pockets of high growth.
   - Internal portfolio management reports (credit exceptions, collateral exceptions, concentrations of credit, etc.).
   - Unfunded loan commitments.
   - Deteriorating trends in asset quality indicators.
   - Any other information related to the risk characteristics of the loan portfolio.

4. Determine, during early discussions with management:

   - How the bank administers the loan portfolio and monitors loan quality.
   - Any significant changes in lending practices.

- Any external or internal factors that could affect loan quality (e.g., local industry reduction or expansion, lending staff changes, changes in credit concentrations).

5. Read minutes of the loan committee meetings to review the bank's lending practices.

6. Use bank reports to select an appropriate sample of loans from the bank's loan portfolio (commercial, retail, etc.). Exclude the small business "basket" loans (see OCC Banking Bulletin 93-18, "Interagency Policy on Small Business Loan Documentation"). Consult with the EIC in determining the loan sample. Consider:

   - Loans on the problem loan list and loans previously classified, significant past-dues, nonaccruals, troubled debt, and restructured loans. (Note: Loans that are not reviewed in detail should be discussed without preparing linesheets.)
   - Insider loans.
   - Large-dollar commercial loans.
   - Participations purchased and sold.
   - Significant concentrations.
   - New loans.

Note: The size and composition of the loan sample should be commensurate with the risk characteristics of the loan portfolio. Common sense and judgment should guide examiners to determine the focus and extent of testing.

For example, assume the loan portfolio has remained relatively unchanged since the last examination and is made up primarily of commercial and industrial loans. A sample of less than 30 percent of the commercial and industrial portfolio may be appropriate. The sample should not necessarily include the same loans reviewed during previous examinations. Conversely, if the bank is offering new or nontraditional loan products or experiencing significant growth, a sampling of the new products or new loans in combination with a smaller sample of commercial loans may be appropriate.

Objective 2: Determine, by testing loans independently, the overall quality and credit risk of the loan portfolio.

1. Analyze credits and discuss loans sufficiently to determine a risk rating for each loan reviewed. The analysis should include a review of related debt.

2. Determine from a portfolio viewpoint the credit risk inherent in the loan portfolio, considering underwriting, concentrations, pricing, collateral coverage, etc.

3. Document and support the reasons for each loan rating. Refer to PPM 5400-8, "Examination Working Papers," for documentation and working paper requirements.

4. Maintain a list of loans for which the examiners' or management's ability to rate the loan was impaired because of a lack of sufficient information on credit or collateral. Consider:

   - Patterns or root causes of exceptions.
   - Relation of exceptions to credit processes.
   - The impact on credit risk.

5. Review and discuss past-due retail loans (residential real estate, consumer loans, check credit, etc.) with management. Unless warranted, detailed line sheets should not be prepared. Classify those loans under OCC classification guidelines.

Objective 3: Determine credit risk associated with other assets.

1. As appropriate, obtain and review a list of the following items:

   - ☐ Other real estate (ORE)
   - ☐ Overdrafts
   - ☐ Repossessed assets
   - ☐ Cash items
   - ☐ Classified investments

2. If the level of credit risk associated with ORE appears significant, review a sample of ORE to determine whether management applies proper accounting treatment. Consider:

   - Timing and recognition of losses.
   - Accounting for expenses.
   - Risk to capital or adequacy of ORE reserves.

3. In discussion with bank management and based on the review of ORE, repossessed assets, cash items, and overdrafts, determine which items should be classified or charged off.

Objective 4: Determine the adequacy of the ALLL.

1. Evaluate the method used to determine the ALLL balance. Consider:

   - The reasonableness of management's process.
   - Findings from the asset quality review.
   - Applicable OCC and interagency guidance.

2. If the method is not consistent with the findings above, consult with the EIC to independently determine the adequacy of the ALLL balance. If the ALLL is determined to be inadequate:

   - Arrive at the necessary provision to restore the ALLL to an acceptable level.
   - Make any necessary adjustments to the call report.
   - As appropriate, share these findings with other examining personnel.

Objective 5: Determine the quality of formal or informal credit risk management systems.

1. Determine whether the number and nature of credit and collateral exceptions, risk rating changes, or other loan review findings adversely affects the quality of the credit administration function.

2. Using the findings from fulfilling the previous objectives, consult with the EIC and other appropriate examining personnel to make

preliminary judgments on the adequacy of portfolio risk management systems. Consider:

- Weaknesses in recognizing and understanding existing risk.
- Evidence that risk is not measured in an accurate or timely manner.
- Whether management accurately and appropriately monitors established risk levels.
- Failure to establish, communicate, and control risk limits.

Objective 6: Based on what was learned while achieving the foregoing objectives, determine significant risk exposure from asset quality.

In consultation with the EIC and other examining personnel, identify any significant risks that should be considered in the risk assessment conclusions. Consider both the aggregate and direction of each risk. Refer to the risk assessment system (appendix B), as needed. Comment as necessary.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action.

If credit risk is moderate and increasing or high, or asset quality is rated 3 or worse:

- Determine whether management is able to correct the bank's fundamental problems.
- Consider whether to expand the scope of the examination to determine the root cause of problems. Refer to appropriate booklets of the *Comptroller's Handbook*.
- Work with the EIC to propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office, if warranted.

Objective 8: Conclude the asset quality review.

1. Provide management with a list of credit exceptions, classified assets, assets listed as special mention, and loan write-ups, as appropriate.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments for appropriate OCC electronic files and the report of examination (e.g., asset quality, concentrations, MRBA, etc.).

3. Update appropriate OCC electronic files and working papers.

4. In discussion with the EIC, provide preliminary conclusions about the aggregate and direction of credit risk or any other applicable risk. As appropriate, complete the summary conclusions in appendix B.

Management

Conclusion: Management is rated (1, 2, 3, 4, 5).

Using the findings from fulfilling the following objectives and in consultation with the EIC and appropriate examining personnel, assign the component rating. Consider the following factors from OCC 97–1, “Uniform Financial Institutions Rating System and Disclosure of Component Ratings”:

- Conclusions from all examination areas.
- The level and quality of oversight and support of all the bank’s activities by the board of directors and management.
- The ability of the board of directors and management, in their respective roles, to plan for and respond to risks that may arise from changing business conditions or new activities or products.
- The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.
- The accuracy, timeliness, and effectiveness of management information and risk-monitoring systems appropriate for the institution’s size, complexity, and risk profile.
- The adequacy of audits and internal controls to promote effective operations and reliable financial and regulatory reporting; to safeguard assets; and to ensure compliance with laws, regulations, and internal policies.
- Compliance with laws and regulations.
- Responsiveness to recommendations from auditors and supervisory authorities.
- Management depth and succession.
- The extent to which the board of directors and management is affected by, or susceptible to, a dominant influence or concentration of authority.
- Reasonableness of compensation policies and avoidance of self-dealing.
- Demonstrated willingness to serve the legitimate banking needs of the community.
- The overall performance of the institution and its risk profile.

Objective 1: Conduct scope-setting and database management activities.

1. Review the documents included in the examination packet to identify any previous problems that require follow-up.

2. As appropriate, use the following documents to complete this module:

   - ☐ Board minutes since the last examination.
   - ☐ Current organizational chart.
   - ☐ Findings from monitoring activities.
   - ☐ List of directors and their backgrounds.
   - ☐ Recent representative packet of board meeting materials.

3. Update the list of directors and executive officers in appropriate OCC electronic files and working papers.

Objective 2: Determine the adequacy of management and board oversight.

1. At the beginning of the examination, discuss with senior management:

   - Major risks – current or planned – and management's strategies to control them.
   - Changes, or planned changes, in senior management or the board since the last examination.
   - The board or board committee structure.
   - Plans for growth or acquisition. Consider:
     - Board-approved strategic plan.
     - Financial and operational plans.
   - The potential impact of management succession plans.

2. Review the minutes of board meetings held since the last examination. Identify any:

   - Violations of law – potential or actual.
     Report any violations of insider laws, regulations, and polices to the EIC.
   - Changes in bank operations or strategy and whether these were approved as part of the bank's strategic planning process.
   - Individuals or factions exercising control over the bank.

- Directors who are involved in the management of the bank and the degree of their involvement.
- Changes in the bylaws or articles of association.
- Directors who do not regularly attend board meetings.
  - Ascertain the reason(s).
  - Assess whether these individuals are fulfilling their fiduciary responsibilities.

Objective 3: Determine the quality of formal or informal risk management systems.

Using the findings from fulfilling the previous objectives, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems. Consider:

- Weaknesses in recognizing and understanding existing risk.
- Evidence that risk is not measured in an accurate or timely manner.
- Failure to establish, communicate, and control risk limits.
- Whether management accurately and appropriately monitors established risk levels.

Objective 4: Determine the impact of the aggregate level or direction of applicable risks on management (practices, qualifications, staffing levels, etc.).

In consultation with the EIC and other examining personnel, decide whether findings from other areas (e.g., quality of risk management practices, direction of risk, or aggregate risk) affect the management conclusion. Refer to the risk assessment system (appendix B), as needed. Comment as necessary.

Objective 5: Determine whether to expand the procedures or develop a plan for corrective action.

If any of the risks are moderate and increasing or high, or management is rated 3 or worse, develop, in consultation with the EIC and the assistant deputy comptroller, action plans to address deficiencies before conducting the exit meeting. Consider:

- Management's ability to correct the bank's fundamental problems.
- Whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklets of the *Comptroller's Handbook*.

Objective 6: Conclude the management review.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose appropriate comments (management/administration, MRBA, etc.) in the report of examination.

2. Update applicable OCC electronic files and working papers.

3. In discussion with all examining personnel, draw preliminary conclusions about the level of transaction, reputation, compliance, strategic risk, or any other applicable risk, as well as about the direction of those risks. As appropriate, complete the summary conclusions in appendix B.

Earnings

Conclusion: Earnings are rated (1, 2, 3, 4, 5).

Using the findings from fulfilling the following objectives and in consultation with the EIC and appropriate examining personnel, assign the component rating. Consider the following factors from OCC Bulletin 97–1, “Uniform Financial Institutions Rating System and Disclosure of Component Ratings”:

- The level of earnings, including trends and stability.
- The ability to provide for adequate capital through retained earnings.
- The quality and sources of earnings.
- The level of expenses in relation to operations.
- The adequacy of the budgeting systems, forecasting processes, and management information systems in general.
- The adequacy of provisions to maintain the allowance for loan and lease losses and other valuation allowance accounts.
- The earnings exposure to market risks such as interest rate, foreign currency translation, and price risks.

Objective 1: Conduct scope-setting activities.

1. Review the documents included in the examination packet to identify any previous problems that require follow-up.

2. Obtain and review these documents to complete this module:

   ☐ Most current balance sheet and income statement.
   ☐ Most recent budget, variance reports, and related items.
   ☐ Most recent annual and quarterly reports.
   ☐ Findings from monitoring activities.

Objective 2: Determine the quality and composition of earnings.

1. Review applicable information to identify trends. Consider:

   - Results from monitoring activities.

- Management reports, UBPR, BERT, and QCALC calculations to compare the bank's ratios with those of peer banks.
- The bank's present condition and future plans.

2. As necessary, discuss earnings trends and variances with management. Coordinate discussions with those performing other functional areas.

3. Analyze earnings composition and trends. Focus on:

   - Core earnings.
   - Net interest margins.
   - Noninterest income and expenses.
   - Loan loss provisions.
   - Off-balance-sheet items.
   - Changes in balance sheet composition.
   - Loan and deposit pricing.

4. Determine the root causes of any significant trends and the impact of nonrecurring items. Consider:

   - Whether earnings trends are improving, stable, or declining.
   - Bank earnings compared with:
     - Budget.
     - Earnings of peer group.
   - Adequacy of bank earnings in relation to:
     - Debt service requirements of the bank's owner.
     - Dividend-paying capacity.
       (If appropriate and in conjunction the examiner reviewing capital, review and discuss with management the bank's dividend plans.)

5. As appropriate, adjust the bank's reported earnings to reflect the results of the examination and project the current year's net income. Distribute adjustments to appropriate examining personnel.

Objective 3: Evaluate the bank's budgeting process.

Review and determine the reasonableness of the bank's budget. Consider:

- Economic, market, and other assumptions.
- Historical performance of the budgeting process.
- Examination results.
- Changes in bank management or strategies.
- Variance reports and other supplemental budgeting reports.

Objective 4: Determine the risk to bank earnings posed by the aggregate level or direction of any applicable risks.

In consultation with the EIC and other examining personnel, does the aggregate level or direction of any risk have an adverse impact on the bank's future earnings? Refer to the risk assessment system (appendix B), as needed. Comment as necessary. Consider:

	Aggregate		Direction		
	Yes	No	Yes	No	NA
Credit risk	☐	☐	☐	☐	☐
Interest rate risk	☐	☐	☐	☐	☐
Liquidity risk	☐	☐	☐	☐	☐
Price risk	☐	☐	☐	☐	☐
Foreign Currency Translation risk	☐	☐	☐	☐	☐
Transaction risk	☐	☐	☐	☐	☐
Compliance risk	☐	☐	☐	☐	☐
Reputation risk	☐	☐	☐	☐	☐
Strategic risk	☐	☐	☐	☐	☐

Objective 5: Determine whether to expand the procedures or develop a plan for corrective action.

If any risk to earnings is moderate and increasing or high, or if earnings are rated 3 or worse:

- Determine whether management is able to correct the bank's fundamental problems.

- Consider whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklet of the *Comptroller's Handbook*.
- Work with the EIC to propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office, if warranted.

Objective 6: Conclude the earnings review.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose appropriate comments (for example, on earnings and in MRBA) in the report of examination.

2) Update applicable OCC electronic files and working papers.

Liquidity

Conclusion: Liquidity is rated (1, 2, 3, 4, 5).

Using the findings from fulfilling the following objectives and in consultation with the EIC and appropriate examining personnel, assign the component rating. Consider the following factors from OCC 97–1, “Uniform Financial Institutions Rating System and Disclosure of Component Ratings”:

- The adequacy of liquidity sources compared with present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
- The availability of assets readily convertible to cash without undue loss.
- Access to money markets and other sources of funding.
- The level of diversification of funding sources, both on- and off-balance-sheet.
- The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer term assets.
- The trend and stability of deposits.
- The ability to securitize and sell certain pools of assets.
- The capability of management to properly identify, measure, monitor, and control the institution’s liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.

Objective 1: Conduct scope-setting activities.

1. Review the documents included in the examination packet to identify any previous problems that require follow-up in this area.

2. Obtain and review the following items:

   ☐ Most recent liquidity reports.
   ☐ The investment trial balance.
   ☐ List of investments purchased and sold (within a reasonable time frame).

- ☐ An appropriate sample of dealer confirmation tickets.
- ☐ The board-approved list of securities dealers.
- ☐ Findings from monitoring activities.
- ☐ Any other information or reports management uses (asset/liability committee packages and minutes, etc.).

3. Discuss current investment, liquidity, and funds management strategies with appropriate management.

Objective 2: Determine the impact of the investment portfolio on liquidity, earnings, capital, and asset quality.

1. In discussion with the examiner(s) evaluating the bank's financial performance, review the UBPR and other MIS to evaluate:

   - Investment yields.
   - Effectiveness of management's investment strategies.
   - Impact of depreciation/amortization on earnings performance or capital adequacy.

2. Assess the composition of the investment portfolio. Consider:

   - Investment types, derivatives, maturities, and concentrations of investments.
   - The investment trial balance, list of purchases and sales over a reasonable time frame, and the sample dealer confirmation tickets.
   - Whether the brokers the bank uses were approved by the board. If not, determine why. Discuss the reasons for any change in brokers with management.

3. From discussions with management and by reviewing internal reports, determine whether there are any issues in the portfolio that are ineligible, in default, or below investment grade.

4. Review credit information for new out-of-area investments, nonrated securities, and industrial development revenue bonds.

5. As appropriate, classify below-grade or impaired investments and distribute findings to the examiner reviewing asset quality.

Objective 3: Determine the adequacy of bank liquidity.

1. Review the UBPR and the most recent liquidity reports. Consider volume and trends in:

   - Retail deposits.
   - Wholesale liabilities and borrowings that may be credit sensitive.
   - Concentrations of liability sources.
   - Liquid assets, including:
     – Fed funds sold.
     – Free securities (i.e., unpledged).
     – Saleable loans.
   - Off-balance-sheet commitments.
   - Liquidity reports including sources and uses of funds statements.

2. Assess the liquidity of the investment portfolio relative to the bank's funding needs. Consider:

   - The percent of securities pledged.
   - The maturity distribution and average life sensitivity of the investment portfolio.
   - The amount of securities held-to-maturity and available-for-sale.
   - How options impact the cash flow patterns of assets and liabilities.

3. Evaluate the adequacy of sources of funds to meet anticipated or potential needs. Consider:

   - The relationship of volume and trends in liabilities to volume and trends of liquid assets.
   - The degree of dependence on volatile liabilities.
   - Funds identified in contingency funding plans.

Objective 4: Determine the quality of formal or informal risk management systems.

Investments

Determine whether management information systems are sufficient for management to make accurate assessments of the liquidity risk.

Liquidity

1. Determine whether management has planned properly for liquidity needs.

2. If wholesale liabilities are significant or if negative trends exist, review the adequacy of management's plan for contingency funding.

Funds Management

Determine whether strategies used to achieve desired mix and maturities of assets and liabilities are adequate. Consider:

- Discussions with management on the bank's liquidity risk strategies.
- Competitive pressures in the local market.
- Maturity matching through normal runoff and reinvestment.
- Asset purchases/sales or borrowings and subordinated note debentures.
- Investment portfolio composition.
- Pricing of loans and deposits.
- Existence of off-balance-sheet items.

Summary

Using the findings from fulfilling the previous objectives, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems. Consider:

- Weaknesses in recognizing and understanding existing risk.
- Evidence that risk is not measured in an accurate or timely manner.
- Failure to establish, communicate, and control risk limits.

- Whether management accurately and appropriately monitors the established risk levels.

Objective 5: Using the findings from fulfilling the foregoing objectives, determine significant liquidity risk exposure.

In consultation with the EIC and other examining personnel, decide whether the aggregate or direction of any risk identified from the liquidity review have an adverse impact on the bank's capital or earnings. Refer to the risk assessment system (appendix B), as needed. Comment as necessary.

Objective 6: Determine whether to expand the procedures or develop a plan for corrective action.

If liquidity risk is moderate and increasing or high, or rated 3 or worse:

- Determine whether management is able to correct the bank's fundamental problems.
- Consider whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklet(s) of the *Comptroller's Handbook*.
- Work with the EIC to propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office, if warranted.

Objective 7: Conclude the liquidity review.

1. Provide the examiner evaluating asset quality with a list of classified investments and communicate findings to other examining personnel, as appropriate.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments on such matters as liquidity and MRBA in the report of examination.

3. Update applicable OCC electronic files and working papers.

4. In discussion with the EIC, provide preliminary conclusions about the aggregate or direction of liquidity risk or any other applicable risk. As appropriate, complete the summary conclusions in appendix B.

Sensitivity to Market Risk

Conclusion: Sensitivity to market risk is rated (1, 2, 3, 4, 5).

Using the findings from achieving the following objectives and in consultation with the EIC and appropriate examining personnel, assign the component rating. (Note: Market risk includes interest rate risk, price risk, and foreign currency translation risk.) Consider the following factors from OCC 97–1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings":

- The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, commodity prices, or equity prices.
- The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile.
- The nature and complexity of interest rate risk exposure arising from nontrading positions.
- When appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

Objective 1: Conduct scope-setting activities.

1. Review the documents included in the examination packet to identify any previous problems that require follow-up in this area.

2. Obtain and review the UBPR and the most recent reports used to monitor and manage interest rate risk (IRR).

Objective 2: Determine the level of price risk or foreign currency translation risk.

1. If the bank trades in securities or engages in any other activity that subjects the bank to price risk or foreign currency translation risk, determine and consider:

- The level of risks in relation to bank capital and earnings.
- The capacity or expertise of bank management.
- The adequacy of risk management systems.

2. Determine whether appropriate accounting treatment is used with respect to trading (FAS 115) and foreign currency translation (FAS 52) accounts.

3. As appropriate and in consultation with the EIC, expand the scope of the review to assess the aggregate and direction of these risks. Refer to appropriate guidance in the *Comptroller's Handbook*.

Objective 3: Determine the quantity of interest rate risk.

1. Review on- and off-balance-sheet instruments. Determine the sensitivity of asset and liability values to interest rate changes. Consider:

   - How management measures interest rate risk (e.g., gap, earnings at risk, equity at risk).
   - The asset and liability maturity structure.
   - The volume of assets and liabilities with options.
   - The volatility of the net interest margin over time.
   - The percentage of long-term assets to total assets.
   - The percentage of mortgages to total assets.

2. For banks whose portfolio includes derivative investments, determine whether the level of risk of these investments is acceptable. Consider:

   - The maturities of assets and liabilities.
   - The volatility of cash flows.
   - The carrying value of total derivatives relative to the bank's capital.
   - The results of any interest rate sensitivity analysis in the bank's files.
   - The current as well as potential impact of instrument volatility relative to the bank's capital and overall risk profile.

Note: If the bank has a significant volume of these investments and they pose high risk, expand the review. Refer to the "Risk Management of Financial Derivatives" booklet of the *Comptroller's Handbook*.

3. Determine whether management evaluates the degree of price sensitivity of the derivative investments. Consider whether management:

   - Relies on and understands stress tests supplied by outside sources.
   - Obtains price valuations from various firms to determine fair prices.

Objective 4: Evaluate management's effectiveness in controlling interest rate risk.

1. Assess the adequacy of bank strategies used to manage interest rate risk. Consider:

   - Competitive pressures in the local market.
   - Repricing mismatches.
   - Asset purchases/sales or liability issuances.
   - Investment portfolio composition.
   - Pricing of loans and deposits.
   - Existence of off-balance-sheet items.
   - Current and projected interest rate environments.

2. Assess the effectiveness of management and the board in overseeing interest rate risk. Consider:

   - The existence and reasonableness of board-approved limits.
   - The adequacy of management's identification, measurement, and monitoring of sources of IRR.
   - Management's ability and willingness to operate within established limits.
   - Management's ability, willingness, capacity, and flexibility to adjust asset/liability mix to reduce IRR.
   - The adequacy of controls over the IRR management process.

Objective 5: Determine the quality of formal or informal risk management systems.

Using the findings from fulfilling the previous objectives, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems. Consider:

- Weaknesses in recognizing and understanding existing risk.
- Evidence that risk is not measured in an accurate or timely manner.
- Failure to establish, communicate, and control risk limits.
- Whether management accurately and appropriately monitors established risk levels.

Objective 6: Using the findings from fulfilling the foregoing objectives, determine significant risk exposure identified from the review of sensitivity to market risk (IRR, price risk, or foreign currency translation risk).

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk noted during the sensitivity to market risk review has an adverse impact on the bank's capital or earnings. Refer to the risk assessment system (appendix B), as needed. Comment as necessary.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action.

If sensitivity to market risk (IRR, price risk, or foreign currency translation risk) is moderate and increasing or high, or sensitivity to market risk is rated 3 or worse:

- Determine whether management is able to correct the bank's fundamental problems.
- Consider whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklet(s) of the *Comptroller's Handbook*.
- Work with the EIC to propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Objective 8: Conclude the review of the bank's sensitivity to market risk.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose comments on such matters as the bank's sensitivity to market risk and MRBA in the report of examination.

2. Update applicable OCC electronic files and working papers.

3. In discussion with the EIC, provide preliminary conclusions on the aggregate and direction of interest rate, price, foreign currency translation, or any other applicable risk. As appropriate, complete the summary conclusions in appendix B.

Other Areas of Examination Interest

Review the documents included in the examination packet to identify any previous problems that require follow-up in these areas.

Audit

Conclusion: The audit function is (acceptable, partly acceptable, unacceptable).

Objective 1: Conduct scope-setting activities.

Obtain the following documents for the review of the audit function:

☐ Most recent external audit report, including the "management letter."
☐ Current year audit schedule, completed and in process.
☐ Most recent internal audit reports, including management's responses.

Objective 2: Determine the scope, independence, and competence of the internal audit function.

Consider:

- Staff experience and training.
- Any incompatible operational duties performed by the auditor or staff.
- Lines of reporting.
- Scope and timeliness of the audit schedule.
- Depth of audit procedures.

Objective 3: Determine the scope, independence, and competence of the external audit function.

Consider:

- External auditor independence. (Note: review any other relationship the auditor may have with the bank.)

- Type of opinion rendered.
- Changes in, or plans to change, the external auditor or audit scope.

Objective 4: Determine the adequacy of management's responsiveness to audit findings and recommendations.

1. As appropriate, review audit findings and recommendations. Consider:

   - Internal and external audit reports.
   - Other reports and communications to and from bank management.

2. Determine whether management has properly addressed exceptions noted by internal or external auditors.

Call Report

Conclusion: Data integrity and processes and controls in preparing the call report (are, are not) adequate.

Objective 1: Determine the adequacy of management processes to prepare call report data.

1. If not previously provided, obtain and review the following documents:

   ☐ Most recent call report.
   ☐ The bank's working papers for that call report.

2. Review and determine the adequacy of the bank's process to prepare call reports.

Objective 2: Determine the accuracy and integrity of call report data.

As appropriate, verify call report data. Consider:

- Asking other examiners if their findings conflict with call report information.

- Determining whether follow-up is needed.
- Testing call report accuracy by randomly checking call report line items against the bank's working papers.

Internal Controls

Conclusion: The overall system of internal controls is (strong, satisfactory, weak).

Objective 1: Determine the adequacy of internal controls.

1. Using the findings from all areas under examination, assess the control environment. As appropriate, consider:

   - The integrity, ethics, and competence of personnel.
   - The organizational structure of the bank.
   - Management's philosophy and operating style (i.e., strategic philosophy).
   - External influences affecting operations and practices (e.g., independent audits).
   - Methods of assigning authority and responsibility, and organizing and developing people.
   - The attention and direction provided by the board of directors and its committees, especially the audit or risk management committees.

2. Using the findings from all areas under examination, assess the bank's internal risk assessment system. As appropriate, consider:

   - External and internal factors that could help to determine whether the bank achieves its strategic initiatives.
   - Identification and analysis of risks.
   - The system used to manage and monitor the risks.
   - The responsiveness of the system to changing risk conditions.
   - The competency, knowledge, and skills of personnel responsible.

3. Using the findings from all areas under examination, assess the bank's control activities. As appropriate, consider:

   - Policies and procedures established to ensure that control processes are carried out periodically.
   - The timeliness of control processes.
   - Reviews of operating activities.
   - Approvals and authorization for transactions and activities.
   - Segregation of duties.
   - Vacation requirements or periodic rotation of duties for personnel in sensitive positions.
   - Safeguarding access to and use of sensitive assets and records.
   - Independent checks or verifications on function performance and reconciliation of balances.
   - Accountability.

4. Using the findings from all areas under examination, assess the bank's accounting, information, and communication systems. As appropriate, consider:

   - MIS that identify and capture relevant internal and external information in a timely manner.
   - Accounting systems that ensure accountability for related assets and liabilities.
   - Information systems that ensure effective communication of positions and activities.
   - Contingency planning for information systems.

5. Using the findings from all areas under examination, assess the bank's self-assessment and monitoring system. As appropriate, consider:

   - Periodic evaluation, self-assessments, or independent audit of internal controls.
   - The system that ensures timely and accurate reporting of deficiencies.
   - Processes that ensure timely modification of policies and procedures, as needed.

Specialty

Conclusion: If significant issues were identified during the last compliance or specialty examination, actions taken by management (are, are not) adequate.

Objective 1: Determine whether the last compliance or specialty examination raised items for management attention.

Objective 2: Determine whether actions taken by management appropriately address the deficiencies identified.

Miscellaneous

Conclusion: Other information reviewed (does, does not) affect the condition of the bank.

Objective 1: Review miscellaneous information that may have an adverse impact on the overall condition of the bank or affect the aggregate or direction of any risk.

1. Obtain and review the following items:

   - ☐ List of significant pending litigation, including a description of the circumstances.
   - ☐ Details about the bank's blanket bond insurance.
   - ☐ List of related organizations (e.g., parent holding company, affiliates, and operating subsidiaries).
   - ☐ Summary of payments to bank affiliates.

2. Review pending or threatened litigation with management to determine whether litigation has a potentially significant impact on the financial condition of the bank.

3. Review insurance policies (blanket bond, liability, etc.) to determine whether they are current and provide adequate coverage.

4. Review the relationship – financial or operational – between the bank and the bank's related organizations. Determine whether the transactions between the bank and its related organizations are legal and conform to proper accounting standards and OCC guidance. Consider the impact on:

    - Earnings
    - Capital
    - Funds management practices
    - Management

Conclusions – Other Areas of Examination Interest

Using the review of the sections on other areas of examination interest (audit, call report, internal controls, BIS, and miscellaneous), achieve the following objectives:

Objective 1: Determine the quality of formal or informal risk management systems.

Using the findings from fulfilling the objectives for other areas of examination interest, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems. Consider:

- Whether management is able to correct any fundamental problems.
- Whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklets of the *Comptroller's Handbook*.

Objective 2: Using the findings from fulfilling the foregoing objectives, determine significant risk exposure from the other areas reviewed during the examination.

Discuss the findings and any identified risks in these other areas with the EIC and determine whether the risks are significant enough to adversely affect the bank's condition or risk profile. Refer to the risk assessment system (appendix B), as needed. Comment as necessary.

Objective 3: Determine whether to expand the procedures or develop a plan for corrective action.

If the risk identified in these other examination areas represents a significant risk to the bank's overall profile:

- Determine whether management is able to correct the bank's fundamental problems.
- Consider whether to expand the scope of the examination to determine the root cause of problems. Refer to the appropriate booklets of the *Comptroller's Handbook*.
- Work with the EIC to propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Objective 4: Conclude the examination of other areas.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose comments for appropriate core or optional pages in the report of examination.

2. Update applicable OCC electronic files and working papers.

Examination Conclusions and Risk Profile

Conclusion: Determine the overall condition of the bank.

Objective 1: The composite rating is (1, 2, 3, 4, 5).

1. Consider findings from the following examination areas:

   - Capital adequacy.
   - Asset quality.
   - Management capability.
   - Quality and quantity of earnings.
   - Adequacy of liquidity.
   - Sensitivity to market risk.

2. Ensure that the evaluation of all component ratings has considered the following from OCC Bulletin 97–1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings":

   - Institution's size.
   - Institution's sophistication.
   - Nature and complexity of bank activities.
   - Bank risk profile.

Objective 2: Determine the risk profile using the risk assessment system (see appendix B).

Draw a conclusion about aggregate risk and the direction of aggregate risk for each of the applicable risk categories.

Examination Communication, Review, and Closing

Conclusion: Complete the on-site examination.

Objective 1: Finalize the examination. For example, complete the report of examination, upload comments to the OCC's electronic information systems, and hold meetings with management.

1. The EIC, or designee, should make a brief final comment on each CAMELS area (and specialty area, as applicable). The comments should include significant risk-related concerns.

2. In consultation with key examining personnel, the EIC should determine whether the bank's condition and risk profile warrant inclusion of any MRBAs in the report of examination. If so, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for specific guidance.

3. Discuss examination conclusions and review draft report comments with the assistant deputy comptroller or the appropriate supervisory office official.

4. Summarize examination conclusions and the bank's condition in the examination conclusions page of the report.

5. If management is rated 3 or worse, or if the risk profile causes sufficient concern, the EIC should contact the supervisory office before the exit meeting to develop a strategy for addressing the bank's deficiencies.

6. Hold an exit meeting with management to summarize examination findings. Consider:

   - Informing management of areas of success and also identifying areas with weaknesses.
   - Soliciting management's commitment to correct material weaknesses.
   - Discussing the bank's risk profile including conclusions from the risk assessment system.

- Offering examples of acceptable solutions, if known or appropriate.

7. Provide bank management with an approved draft of examination conclusions, MRBA comments, and violations of law to allow managers to review the comments for accuracy.

8. Perform a final technical check to make sure the report is accurate and acceptable. The check should ensure that:

   - The report meets established guidelines.
   - Comments support the composite and UFIRS component ratings (and specialty ratings, as applicable).
   - All numerical totals are footed.
   - All the numerical data in the report and other supervisory comments is consistent with that in the bank's records.
   - Violations of law citations are accurate.

9. If there are MRBA comments in the report, upload them directly to a follow-up analysis in OCC's electronic information system. The comments should also reflect conclusions on management's ability to:

   - Resolve noted problems or issues.
   - Manage the current level of risk. (Comments should describe the likely effects of inaction.)

10. Upload the "Examination Conclusions" report comment to the "Examination Analysis" comment in OCC's electronic information system. Supplement the analysis comment, when appropriate, to include:

    - The scope of the examination.
    - The reasons for changes in the scope of the supervisory strategy for the bank.
    - The findings and conclusions, including the reasons for recommended enforcement actions or civil money penalty referrals.
    - Reasons for rating changes or confirmations.

11. Update electronic supervisory information systems and comments (e.g., core knowledge and statistical data records) including:

    - Risk assessments
    - Ratings
    - Asset statistics
    - Violations
    - BIS process indicator
    - Institution indicators

12. Prepare the supervisory strategy for the next examination cycle. Follow specific guidance as discussed in the introduction of this booklet and further detailed in the *Comptroller's Handbook*, "Bank Supervision Process."

13. Prepare the report and supervisory information comments and records for final review by the supervisory office.

14. Complete and distribute assignment evaluations.

15. If not already done, schedule the board meeting.

Objective 2: Prepare and conduct a meeting with the board of directors.

1. Before completing the on-site examination, prepare for the board meeting by:

    - Drafting a preliminary board meeting agenda (formal or informal).
    - Preparing any handouts, graphics, or audio visual material for the board meeting.
    - Reviewing the backgrounds of all board members.
    - Drafting responses to expected questions and comments.

2. Conduct the meeting after the board, or an authorized committee, has had the opportunity to review the draft report or a synopsis of examination findings. At the meeting, graphics and handouts should be used when appropriate so that the examiner can describe:

- The objectives of OCC's supervision and how the OCC pursues those objectives.
- Strategic issues including growth, products, and strategies.
- Major concerns or issues, including significant risks facing the bank.
- The bank's success or failure in correcting previously identified deficiencies.
- The impact of failing to correct deficiencies.
- What the OCC expects the bank to do and when (i.e., action plans, supervisory strategies, and commitments).
- What the bank is doing well.
- Industry issues affecting the bank.

Note: The supervisory office official, assistant deputy comptroller, or their designee must attend the board meeting.

3. Document details of the meeting in appropriate OCC electronic files. The following information should be included:

   - The date and location of the meeting and attendees.
   - Major items discussed.
   - A brief summary of the directors' reactions to the examiner's briefing. (The electronic file can refer the reader to the follow-up analysis comment for further details on any commitments obtained from the board or senior management.)

4. Close out examination analysis in applicable OCC electronic files.

Risk Assessment System

Credit Risk

Credit risk is the current and prospective risk to earnings or capital arising from an obligor’s failure to meet the terms of any contract with the bank or otherwise to perform as agreed. Credit risk is found in all activities in which success depends on counterparty, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

Summary Conclusions

Aggregate credit risk is:

❐ Low	❐ Moderate	❐ High

The direction of change is expected to be:

❐ Decreasing	❐ Stable	❐ Increasing

Credit Risk Indicators

Low	*Moderate*	*High*
Management fully understands all aspects of credit risk and has a fully effective process in place to control that risk.	Management reasonably understands key aspects of credit risk and has an adequate process in place to control that risk.	Management does not understand, has chosen to ignore, or does not have a satisfactory process in place for key aspects of credit risk.
Management anticipates and identifies issues before they become problems, including those resulting from changes in market conditions.	Management has an adequate system in place to identify problems and adequately respond to those signals, including those resulting from changes in market conditions.	Management does not anticipate problems or is ineffective in responding to problems once they occur.
Policies are effective and adhered to.	Policies are satisfactory.	Policies are ineffective.
Credit risk diversification is actively managed.	Attention to credit risk diversification is adequate.	Credit risk diversification is unsatisfactory.
New extensions are conservative in structure, terms, growth, or settlement practices.	New extensions are prudent in structure, terms, growth, or settlement practices.	New extensions are aggressive in structure, terms, growth, or settlement practices.
Underwriting standards are sound and few or no exceptions exist.	Underwriting standards are sound and only a limited volume of exceptions.	Underwriting standards have not been adequately developed or aggressive deviations from prudent underwriting standards exist. A large volume of exceptions to sound underwriting standards exist.
Concentrations of credit reflect appropriate diversification.	Concentrations of credit reflect adequate diversification.	Significant concentrations of credit exist.
Collateral values satisfactorily support credit exposure.	Collateral values protect credit exposure.	Collateral is illiquid or values provide inadequate support.
The volume of problem credits is low and can be worked through in the normal course of business.	The volume of problem credits is moderate and can be worked through within reasonable time frames.	The volume of problem credits may be high and may require an extended time for resolution.
Reserves adequately cover inherent losses. Exposure to loss of earnings or capital from credit risk is minimal.	Inherent credit-related losses should not seriously deplete current reserves or necessitate more than normal provisions. Exposure to loss of earnings or capital from credit risk is manageable.	Credit-related losses may seriously deplete current reserves or necessitate abnormal provisions to cover remaining inherent losses. Exposure to loss of earnings or capital from credit risk is substantial.
Credit analyses are comprehensive and promote early identification of emerging risks.	Credit analyses are satisfactory, as are risk measurement and monitoring systems.	Credit analyses are not comprehensive or of deficient quality.
Internal grading appropriately stratifies portfolio quality and provides early detection of potential problems.	Internal grading reasonably stratifies portfolio quality.	Internal grading of credit does not accurately reflect the portfolio's quality.
Loan review and audit are timely, comprehensive, and independent.	Loan review and audit are acceptable.	Serious weaknesses exist in loan review and audit such as lack of independence, timeliness, or scope of review.
The ALLL method is sound and appropriate coverage of risks exists.	The ALLL method is generally adequate and coverage of risks is acceptable.	The ALLL method is flawed. It provides insufficient coverage of risks present.

Interest Rate Risk

Interest rate risk is the current and prospective risk to earnings or capital arising from movements in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships among different yield curves affecting bank activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in bank products (options risk).

Summary Conclusions

Aggregate interest rate risk is:

❒ Low	❒ Moderate	❒ High

The direction of change is expected to be:

❒ Decreasing	❒ Stable	❒ Increasing

Interest Rate Indicators

Low	*Moderate*	*High*
Responsible officials fully understand all aspects of interest rate risk.	Responsible officials reasonably understand the key aspects of interest rate risk.	Responsible officials do not understand, or choose to ignore, key aspects of interest rate risk.
Management anticipates and responds well to changes in market conditions.	Management adequately responds to changes in market conditions.	Management does not anticipate or take timely and appropriate actions in response to changes in market conditions.
Knowledge of interest rate risk is well understood at appropriate levels in the institution.	Knowledge of interest rate risk exists at appropriate levels in the institution.	Knowledge of interest rate risk may be concentrated in too few individuals.
Responsibility for monitoring risk limits and measuring exposures is independent from those executing risk-taking decisions.	Responsibility for monitoring risk limits and measuring exposure is independent from those executing risk-taking decisions.	Responsibility for monitoring risk limits and measuring exposures is not independent from those executing risk-taking decisions.
Exposure reflects little repricing risk and minimal exposure to basis risk and yield curve risk. Options positions are clearly identified and well-managed.	Exposure reflects repricing risk, basis risk, yield curve risk, and options risk that, collectively, are maintained at manageable levels.	Exposure reflects significant repricing risk, high levels of basis risk, undue yield curve risk, or significant levels of options risk.
Mismatched positions are short-term.	Mismatched positions may be longer term, but are effectively hedged.	Mismatched positions are longer term and costly to hedge.
The mismatches are unlikely to cause earnings or capital volatility due to the movement of interest rates.	Substantial volatility in earnings or capital due to the movement of interest rates is not anticipated.	The probability of substantial volatility in earnings or capital due to the movement of interest rates is high.
The interest rate risk management process is effective and proactive.	Interest rate risk management process is adequate.	Interest rate risk management process is deficient.
Measurement tools and methods enhance decision making by providing meaningful and timely information under a variety of defined and reasonable rate scenarios.	Measurement tools and methods have minor weaknesses, but are appropriate given the size and complexity of the bank's on- and off-balance-sheet exposures.	The process is overly simplistic in light of the relative size and complexity of the bank's on- and off-balance-sheet exposures.
Management information systems are timely, accurate, complete, and reliable.	Management information is, for the most part, timely, accurate, complete, and reliable.	Management information systems contain significant weaknesses.
Limit structures provide clear parameters for risk to earnings and the economic value of equity under a variety of defined and reasonable interest rate scenarios.	Limit structures are adequate to control the risk to earnings and the economic value of equity under defined and reasonable interest rate scenarios.	Limit structures are not reasonable or do not reflect an understanding of the risks to earnings and the economic value of equity.

Liquidity Risk

Liquidity risk is the current and prospective risk to earnings or capital arising from a bank's inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Summary Conclusions

Aggregate liquidity risk is:

❒ Low	❒ Moderate	❒ High

The direction of change is expected to be:

❒ Decreasing	❒ Stable	❒ Increasing

Liquidity Risk Indicators

Low	*Moderate*	*High*
Management fully understands all aspects of liquidity risk.	Management reasonably understands the key aspects of liquidity risk.	Management does not understand, or chooses to ignore, key aspects of liquidity risk.
Management anticipates and responds well to changes in market conditions.	Management adequately responds to changes in market conditions.	Management does not anticipate or take timely or appropriate actions in response to changes in market conditions.
The liquidity position is favorable with negligible exposure to earnings and capital expected.	The bank is not excessively vulnerable to funding difficulties should an adverse change in market perception occur. Earnings or capital exposure is manageable.	The bank's access to funds is impacted by poor market perception or market resistance, resulting in substantial exposure to loss of earnings or capital.
Ample funding sources exist. Funding sources provide the institution with a competitive cost advantage.	Sufficient funding sources exist to provide cost-effective liquidity.	Funding sources and portfolio structures suggest current or potential difficulty in sustaining long-term and cost-effective liquidity.
Borrowing sources are widely diversified, with little or no reliance on wholesale or other credit-sensitive funds providers.	Borrowing sources are diversified with few providers or groups sharing common investment objectives and economic influences.	Borrowing sources are concentrated in a few providers or providers with common investment objectives or economic influences.
Market alternatives exceed demand for liquidity, with no adverse changes expected.	The liquidity position is not expected to deteriorate in the near term.	Liquidity needs may be increasing with declining medium- and long-term funding alternatives.
Liquidity risk management processes reflect a sound culture that has proven effective over time.	Liquidity risk management processes are adequate.	Liquidity risk management processes are deficient.
Management information is timely, complete, and reliable.	Management information is, for the most part, timely, accurate, complete and reliable.	Management information systems do not provide useful information for managing liquidity risk.
Appropriate attention is given to balance sheet symmetry and the cost effectiveness of liquidity alternatives.	Access to funding markets is properly assessed and diversified, and attention to balance sheet symmetry is appropriate.	Management has not realistically assessed the bank's access to funds and has not paid sufficient attention to diversification. Attention to balance sheet symmetry is inappropriate.
Contingency plans are well-developed and effective.	Contingency planning is effective, and the cost of liquidity alternatives is adequately considered.	Contingency planning is either nonexistent or incomplete. The cost of liquidity alternatives has not been adequately considered. A high probability exists that contingency funding sources are needed. Improvement is not expected in the near future.

Price Risk

Price risk is the risk to earnings or capital arising from changes in the value of traded portfolios of financial instruments. This risk arises from market-making, dealing, and position-taking in interest rate, foreign exchange, equity, and commodities markets.

Summary Conclusions

Aggregate price risk is:

❐ Low	❐ Moderate	❐ High

The direction of change is expected to be:

❐ Decreasing	❐ Stable	❐ Increasing

Price Risk Indicators

Low	*Moderate*	*High*
Management fully understands all aspects of price risk.	Management reasonably understands the key aspects of price risk.	Management does not understand, or has chosen to ignore, key aspects of price risk.
Management anticipates and responds well to changes in market conditions.	Management adequately responds to changes in market conditions.	Management does not anticipate or take timely and appropriate actions in response to changing market conditions. Knowledge of risk exposure is limited or concentrated in too few individuals.
Knowledge of price risk exposure is well-understood at appropriate levels throughout the institution.	Knowledge of risk exposure is adequate and risk is understood at appropriate levels throughout the institution.	Exposure reflects significant open or unhedged positions which subjects earnings or capital to significant volatility from revaluation requirements.
Exposure reflects limited open or unhedged positions. As a result, earnings and capital are vulnerable to nominal volatility from revaluation requirements.	Exposure reflects moderate open or unhedged positions, limiting the vulnerability of earnings and capital to moderate volatility from revaluation requirements.	Exposure may arise from transactions or positions that are taken as a result of management or trader views of the market, or in conjunction with customer transactions.
Exposures are confined primarily to those arising from customer transactions, and involve liquid and readily manageable products, markets, and levels of activity.	Exposure originates primarily in conjunction with customer transactions. The bank has access to a variety of risk management instruments and markets at reasonable costs, given the size, tenor, and complexity of open positions.	The positions may be difficult or costly to close out or hedge due to complexity; difficulty in readily accessing certain instruments, markets or tenors; or the general illiquidity of markets or products.
The frequency and size of position-taking are expected to continue at, or decline from, current levels.	The frequency and size of position-taking are expected to remain at current levels.	The frequency and size of position-taking are expected to continue at, or increase beyond, current levels.
Price risk management processes have few or no deficiencies.	Price risk management processes are adequate.	Price risk management processes are deficient.
Measurement tools and methods are sophisticated, given the size and complexity of activities.	Measurement tools and methods have minor deficiencies, but are sufficient given the size and complexity of activities.	Measurement tools and methods are inadequate given the size or complexity of activities.
Management information provides a clear assessment of the potential volatility and aggregate risk-taking.	Management information reasonably portrays the potential volatility and aggregate risk-taking.	Management information does not accurately characterize potential volatility or aggregate risk-taking.
Valuation methods are "state of the art," independently reviewed, tested, and documented.	Valuation methodologies are acceptable.	Valuation methodologies are flawed.
Limit structures are reasonable, clear, and effectively communicated. The limits reflect a clear understanding of the risk to earnings and capital under a variety of defined and reasonable scenarios.	Limit structures are reasonable, clear and effectively communicated. The limits also reflect a clear understanding of the risk to earnings and capital under defined and reasonable scenarios.	Limit structures may not be reasonable, clear, or effectively communicated. Limits may not reflect a complete understanding of the risk to earnings and capital.
Responsibility for measuring exposures and monitoring risk is independent from risk-taking activities.	Responsibility for measuring exposures and monitoring price risk is independent from risk-taking activities.	Responsibility for measuring exposures and monitoring price risk is not independent from risk-taking activities.

Foreign Currency Translation Risk

Foreign currency translation risk is the current and prospective risk to capital or earnings arising from the conversion of a bank's financial statements from one currency into another. It refers to the variability in accounting values for a bank's equity accounts that results from variations in the exchange rates that are used in translating carrying values and income streams in foreign currencies to U.S. dollars. Market-making and position-taking in foreign currencies should be captured under price risk.

Summary Conclusions

Aggregate foreign currency translation risk is: Not Applicable ❐

❐ Low	❐ Moderate	❐ High

The direction of change is expected to be:

❐ Decreasing	❐ Stable	❐ Increasing

Foreign Currency Translation Risk Indicators

Low	*Moderate*	*High*
The foreign currency translation risk management process is well understood throughout the institution.	The foreign currency translation risk management process is adequate. Knowledge of foreign currency translation risk exposures is adequately understood at appropriate levels.	Knowledge of foreign currency translation risk exposure is limited or concentrated in too few individuals.
Management fully understands all aspects of foreign currency translation risk.	Management reasonably understands the key aspects of foreign currency translation risk.	Management does not understand, or has chosen to ignore, key aspects of foreign currency translation risk.
Management anticipates and responds well to changes in market conditions.	Management adequately responds to changes in market conditions.	Management does not anticipate or take timely or appropriate actions in response to changes in market conditions.
Exposure reflects non-dollar denominated positions that are largely hedged.	Exposure may reflect large non-dollar denominated positions that are open, but can be readily hedged at a reasonable cost.	Exposure reflects large non-dollar denominated positions, or cash flow mismatches, that are unhedged.
Cash flows are predictable and are closely matched or hedged.	Cash flow mismatches are predictable and moderate in size.	Some positions may be denominated in relatively illiquid currencies, complicating the ease, speed, and cost of hedging.
There is negligible volatility to earnings or capital because of translation adjustments.	There is moderate volatility to earnings or capital due to translation adjustments.	There is substantial volatility to earnings or capital due to translation adjustments.
Risk measurement tools and methods are sophisticated, given the size and complexity of activities.	Risk measurement tools and methods may have minor deficiencies, but are sufficient given the size and complexity of activities.	Risk measurement tools and methods are inadequate given the size or complexity of activities.
Management information systems provide a clear assessment of the potential volatility and aggregate risk-taking.	Management information systems provide a reasonable assessment of the potential volatility and aggregate risk-taking.	Management information systems do not accurately portray the potential volatility or aggregate risk-taking.
Limit structures are reasonable, clear, and effectively communicated.	Limit structures are reasonable, clear, and effectively communicated.	Limit structures are not reasonable, clear, or effectively communicated.
Limits reflect a clear understanding of the risk to earnings and capital under a variety of defined and reasonable scenarios.	Limits reflect an understanding of the risk to earnings and capital under a defined yet reasonable scenario.	Limits do not reflect a complete understanding of the risk to earnings and capital.
Qualified individuals, independent from risk-taking activities, have the responsibility for measuring exposures and monitoring risk.	Responsibility for measuring exposures and monitoring risk is independent from risk-taking activities.	Responsibility for measuring exposures and monitoring risks is not independent from risk-taking activities.

Transaction Risk

Transaction risk is the current and prospective risk to earnings and capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information. Risk is inherent in efforts to gain strategic advantage and in the failure to keep pace with changes in the financial services marketplace. Transaction risk is evident in each product and service offered. Transaction risk encompasses product development and delivery, transaction processing, systems development, computing systems, complexity of products and services, and the internal control environment.

Summary Conclusions

Aggregate transaction risk is:

❒ Low	❒ Moderate	❒ High

The direction of change is expected to be:

❒ Decreasing	❒ Stable	❒ Increasing

Transaction Risk Indicators

Low	*Moderate*	*High*
Management fully understands all aspects of transaction risk. Management anticipates and responds well to market and technological changes.	Management reasonably understands the key aspects of transaction risk. Management adequately responds to changes of a market or technological nature.	Management does not understand, or has chosen to ignore, key aspects of transaction risk. Management does not anticipate or take timely and appropriate actions in response to market or technological changes.
The volume and complexity of transaction processing is low and well supported by systems development.	The volume and complexity of transactions expose the bank to some degree of risk. Systems development adequately supports the level of transaction processing.	The level of transaction processing and state of systems development are inconsistent and reflect weaknesses.
Possible damage to reputation, or loss of earnings and capital, is slight.	Possible loss to reputation, earnings, or capital exists but is mitigated by adequate internal controls.	Weak internal controls expose the bank to significant damage to reputation, or loss of earnings or capital.
The bank has a history of sound operations. The likelihood of future transaction processing failures is minimal because of the presence of strong internal controls.	The bank has a history of adequate operations. The likelihood of future transaction processing failures is minimized by generally effective controls.	The bank may have a history of transaction processing failures. The likelihood of future processing failures is high because of the absence of effective internal controls.
The bank has a strong control culture that results in systems, internal controls, audit, and contingency and business recovery plans that are sound.	Adequate operating and information processing systems, internal controls, audit coverage, and contingency and business recovery plans are evident.	Serious weaknesses exist in operating and information systems, internal controls, audit coverage or contingency and business recovery plans.
Management information is satisfactory.	Minor deficiencies may exist in management information that relates to transaction and information processing activities.	Management information related to transaction processing activities exhibits significant weaknesses.
Management has demonstrated favorable performance in acquisitions and the introduction of new products and services.	Planning and due diligence are performed although minor weaknesses exist.	Planning or due diligence may be inadequate, exposing the bank to risk from the introduction of new products and services or acquisitions.
Implementation plans are clear and followed.	Implementation plans are evident although they are not always comprehensive.	The bank may be exposed to processing risks because of poor conversion management, either from the integration of new acquisitions with existing systems, or from converting one system to another.
Management identifies weaknesses quickly and takes appropriate action.	Management recognizes weaknesses and generally takes appropriate action.	Management has not demonstrated a commitment to make the corrections required to improve transaction processing risk controls.

Compliance Risk

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards. Compliance risk also arises when the laws or rules governing certain bank products or activities of the bank's clients may be ambiguous or untested. This risk exposes the institution to fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential, and lack of contract enforceability.

Summary Conclusions

Aggregate compliance risk is:

❒ Low	❒ Moderate	❒ High

The direction of change is expected to be:

❒ Decreasing	❒ Stable	❒ Increasing

Compliance Risk Indicators

Low	*Moderate*	*High*
Management fully understands all aspects of compliance risk and exhibits a clear commitment to compliance. The commitment is communicated throughout the institution.	Management reasonably understands the key aspects of compliance risk. Its commitment to compliance is reasonable and satisfactorily communicated.	Management does not understand, or has chosen to ignore, key aspects of compliance risk. The importance of compliance is not emphasized or communicated throughout the organization.
Authority and accountability for compliance are clearly defined and enforced.	Authority and accountability are defined, although some refinements may be needed.	Management has not established or enforced accountability for compliance performance.
Management anticipates and responds well to changes of a market or regulatory nature.	Management adequately responds to changes of a market or regulatory nature.	Management does not anticipate or take timely or appropriate actions in response to changes of a market or regulatory nature.
Compliance considerations are incorporated into product and system development processes.	While compliance may not be formally considered when developing products and systems, issues are typically addressed before they are fully implemented.	Compliance considerations are not incorporated in product or systems development.
Violations or noncompliance issues are insignificant, as measured by their number or seriousness.	The frequency or severity of violations or noncompliance is reasonable.	Violations or noncompliance expose the company to significant impairment of reputation, value, earnings, or business opportunity.
When deficiencies are identified, management promptly implements meaningful corrective action.	Problems can be corrected in the normal course of business without a significant investment of money or management attention. Management is responsive when deficiencies are identified.	Errors are often not detected internally, corrective action is often ineffective, or management is unresponsive.
The institution has a good record of compliance. The bank has a strong control culture that has proven effective. Compliance management systems are sound and minimize the likelihood of excessive or serious future violations or noncompliance.	Compliance management systems are adequate to avoid significant or frequent violations or noncompliance.	Compliance management systems are deficient, reflecting an inadequate commitment to risk management.
Appropriate controls and systems are implemented to identify compliance problems and assess performance.	No shortcomings of significance are evident in controls or systems. The probability of serious future violations or noncompliance is within acceptable tolerance.	The likelihood of continued violations or noncompliance is high because a corrective action program does not exist, or extended time is needed to implement such a program.
Training programs are effective and the necessary resources have been provided to ensure compliance.	Management provides adequate resources and training given the complexity of products and operations.	Management has not provided adequate resources or training.

Strategic Risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

Summary Conclusions

Composite strategic risk is:

❒ Low	❒ Moderate	❒ High

The direction of change is expected to be:

❒ Decreasing	❒ Stable	❒ Increasing

Strategic Risk Indicators

Low	*Moderate*	*High*
Risk management practices are an integral part of strategic planning.	The quality of risk management is consistent with the strategic issues confronting the organization.	Risk management practices are inconsistent with strategic initiatives. A lack of strategic direction is evident.
Strategic goals, objectives, corporate culture, and behavior are effectively communicated and consistently applied throughout the institution. Strategic direction and organizational efficiency are enhanced by the depth of management talent.	Management has demonstrated the ability to implement goals and objectives and successful implementation of strategic initiatives is likely.	Strategic initiatives are inadequately supported by the operating policies and programs that direct behavior. The structure and talent of the organization do not support long-term strategies.
Management has been successful in accomplishing past goals and is appropriately disciplined.	Management has a reasonable record in decision making and controls.	Deficiencies in management decision making and risk recognition do not allow the institution to effectively evaluate new products, services, or acquisitions.
Management information systems effectively support strategic direction and initiatives.	Management information systems reasonably support the company's short-term direction and initiatives.	Management information systems supporting strategic initiatives are seriously flawed or do not exist.
Exposure reflects strategic goals that are not overly aggressive and are compatible with developed business strategies.	Exposure reflects strategic goals that are aggressive but compatible with business strategies.	Strategic goals emphasize significant growth or expansion that is likely to result in earnings volatility or capital pressures.
Initiatives will have a negligible impact on capital, systems, or management resources. The initiatives are well supported by capital for the foreseeable future and pose only nominal possible effects on earnings volatility.	The corporate culture has only minor inconsistencies with planned initiatives. The initiatives are reasonable considering the capital, systems, and management available to support them. Decisions are not likely to have a significant adverse impact on earnings or capital. If necessary, the decisions or actions can be reversed without significant cost or difficulty.	The impact of strategic decisions is expected to significantly affect franchise value. Strategic initiatives may be aggressive or incompatible with developed business strategies. Decisions are either difficult or costly to reverse.
Initiatives are supported by sound due diligence and strong risk management systems. The decisions can be reversed with little difficulty and manageable costs.	Strategic initiatives will not materially alter business direction, can be implemented efficiently and cost effectively, and are within management's abilities.	Strategic goals are unclear or inconsistent, and have led to an imbalance between the institution's tolerance for risk and willingness to supply supporting resources.

Reputation Risk

Reputation risk is the current and prospective impact on earnings and capital arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with its customers and the community.

Summary Conclusions

Composite reputation risk is:

❒ Low	❒ Moderate	❒ High

The direction of change is expected to be:

❒ Decreasing	❒ Stable	❒ Increasing

Reputation Risk Indicators

Low	*Moderate*	*High*
Management anticipates and responds well to changes of a market or regulatory nature that impact its reputation in the marketplace.	Management adequately responds to changes of a market or regulatory nature that impact the institution's reputation in the marketplace.	Management does not anticipate or take timely or appropriate actions in response to changes of a market or regulatory nature.
Management fosters a sound culture that is well supported throughout the organization and has proven very effective over time.	Administration procedures and processes are satisfactory. Management has a good record of correcting problems. Any deficiencies in management information systems are minor.	Weaknesses may be observed in one or more critical operational, administrative, or investment activities. Management information at various levels exhibits significant weaknesses.
The bank self-polices risks.	The bank effectively self-polices risks.	The institution's performance in self-policing risk is suspect.
Internal controls and audit are fully effective.	Internal controls and audit are generally effective.	Internal controls or audit are not effective in reducing exposure. Management has either not initiated, or has a poor record of, corrective action to address problems.
Franchise value is only minimally exposed by reputation risk. Exposure from reputation risk is expected to remain low in the foreseeable future.	The exposure of franchise value from reputation risk is controlled. Exposure is not expected to increase in the foreseeable future.	Franchise value is substantially exposed by reputation risk shown in significant litigation, large dollar losses, or a high volume of customer complaints. The potential exposure is increased by the number of accounts, the volume of assets under management, or the number of affected transactions. Exposure is expected to continue in the foreseeable future.
Losses from fiduciary activities are low relative to the number of accounts, the volume of assets under management, and the number of affected transactions. The bank does not regularly experience litigation or customer complaints.	The bank has avoided conflicts of interest and other legal or control breaches. The level of litigation, losses, and customer complaints are manageable and commensurate with the volume of business conducted.	Poor administration, conflicts of interest, and other legal or control breaches may be evident.

Request Letter Enclosure

The information should be as of *(examination as-of date)*, unless otherwise indicated.

Management and Supervision

Please **provide copies** of the following:

1. The most recent board packet. Any information included in the packet and requested below need not be duplicated.

2. Current organizational chart.

3. List of directors and their backgrounds, including work experience, length of service with the bank, etc. Also, list of committees, including current membership.

4. List of related organizations (e.g., parent holding company, affiliates, and operating subsidiaries).

Please **make available** the following upon our arrival at the bank:

5. Board meeting minutes since the last examination.

Asset Quality

Please **provide copies** of the following:

6. List of problem loans, past-due credits, and nonaccrual loans.

7. Most recent concentrations of credit reports.

8. List of insider credits (to directors, executive officers, and principal shareholders) and their related interests. This list should include terms (rates, collateral, structure, etc.).

9. List of the participations purchased and sold.

10. List of overdrafts.

11. Most recent analysis of the allowance for loan and lease losses.

12. List of other real estate, repossessed assets, and cash items.

13. List of small business and farm loans "exempt" from documentation requirements.

14. Latest loan review report, including any responses from the senior lending officer, account officers, etc.

Please **make available** the following upon our arrival at the bank:

15. Most recent loan trial balance.

16. Loan committee meeting minutes since the last examination.

Financial Performance

Please **provide copies** of the following:

17. Most recent reports used to monitor and manage interest rate risk, e.g., gap planning, simulation models, and duration analysis.

18. Most recent liquidity reports.

19. List of investment securities purchased and sold for (current year) and (prior year). Please include amount, seller/buyer, and date of each transaction.

20. List of structured notes reported on recent call report. Please have investment prospectus and any market value stress test on each issue available.

21. Most current balance sheet and income statement.

22. Most recent strategic plan, budget, variance reports, etc.

23. Current risk-based capital computation.

Please **make available** the following upon our arrival at the bank:

24. Investment portfolio summary trial.

25. The list of board-approved securities dealers.

26. Dealer confirmation tickets.

27. Asset/liability committee meeting minutes since the last examination.

28. List of shareholders and ownership.

29. Most recent annual and quarterly *shareholders'* reports.

Other Areas of Interest

Please **provide copies** of the following:

30. Most recent external audit report, including engagement letter, and management's response.

31. (Current year) audit schedule, including audits completed and in process.

32. Most recent Report of Condition and Income (call report).

33. List of pending litigation, including a description of circumstances behind the litigation.

34. Details regarding the bank's blanket bond insurance policy, including name of insurer, amount of coverage and deductible, and maturity. Also, please indicate whether the bank intends to maintain the same coverage upon maturity.

35. Summary of payments to the holding company and any affiliates.

Please **make available** the following upon our arrival at the bank:

36. Most recent internal audit reports including management's responses. Include (prior year) audit reports covering loan administration, funds management and investment activities, and risk-based capital computations.

37. Audit committee meeting minutes since the last examination.

38. Bank working papers for the most recent call report submitted.

OCC Issuances

Comptroller's Handbook, "Bank Supervision Process"
Comptroller's Handbook, "Examination Planning and Control"
Comptroller's Handbook, "Large Bank Supervision"
Examining Circular 263, "Supervisory Monitoring System"
OCC Banking Bulletin 93-18, "Interagency Policy on Small Business Loan Documentation"
OCC Bulletin 97-1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings"
PPM 5400-8, "Examination Working Papers"